

Office - Supreme Court, U. S.
FILED

MAY 27 1940

CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 1044

105

311
60

Uni

THE UNION TRUST COMPANY OF INDIANAPOLIS,
as Former Executor of the Last Will and Testament of
William H. Block, Deceased,

Petitioner and Appellant, below,

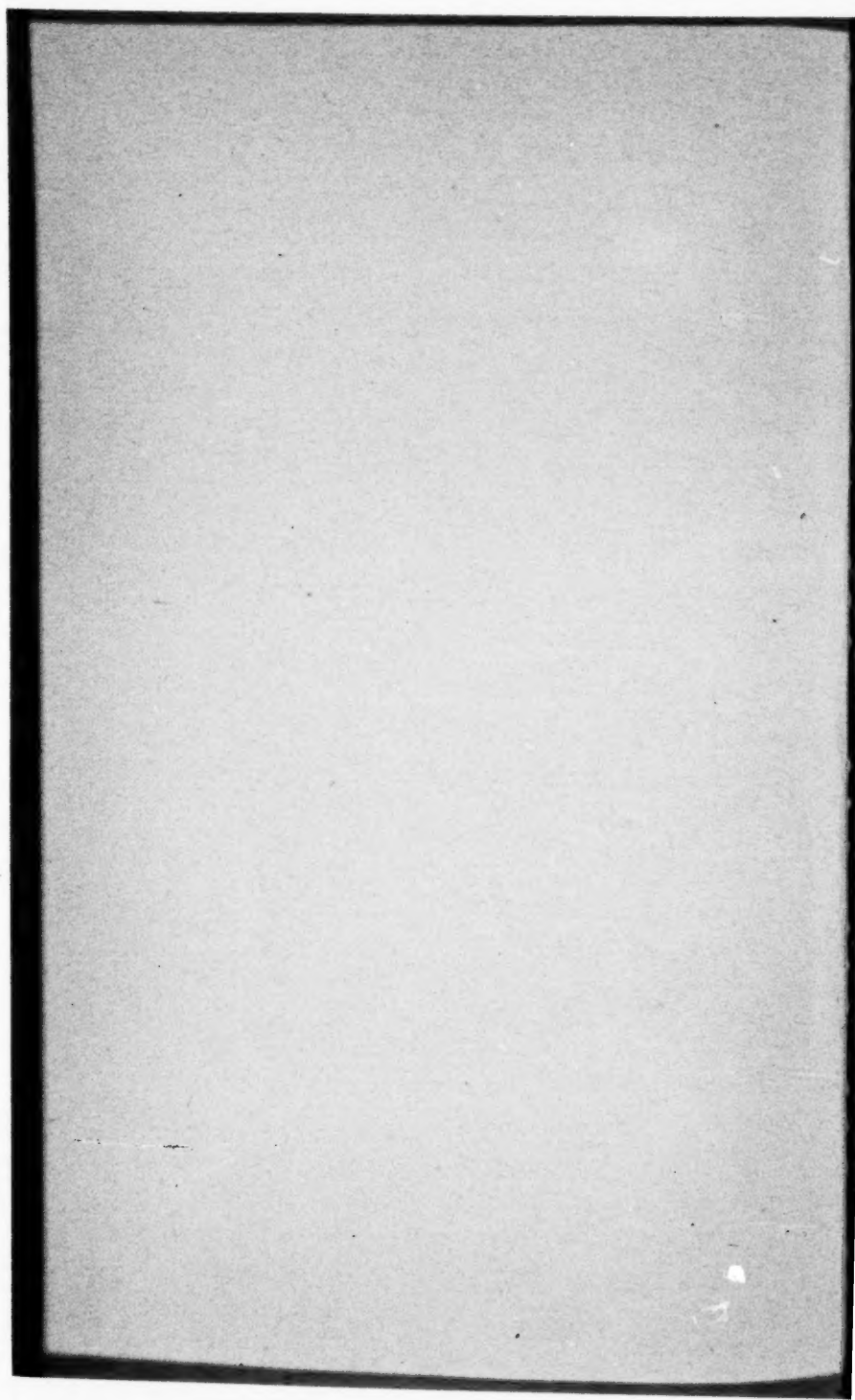
v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee below.

PETITION FOR WRIT OF CERTIORARI.
With Supporting Brief.

PAUL Y. DAVIS,
KURT F. PANTZER,
Counsel for Petitioner.

ERNEST R. BALTZELL,
WILLIAM G. SPARKS,
GUSTAV H. DONGUS,
Of Counsel.



SUBJECT INDEX

	Page
Table of Authorities	ii
Petition for Writ of Certiorari.....	1
Summary Statement of Matter Involved.....	1-3
Jurisdiction to Review the Judgment.....	3
Questions Presented	4
Reasons Relied on for the Allowance of the Writ.....	5-8
Prayer for Writ	8
Brief in Support of Petition for Writ of Certiorari.....	9
The Opinion of the Court below (reference).....	9
Jurisdiction to Review the Judgment.....	9-10
Statement of the Case.....	10-14
First. The Taxability of the Estate Tax Refund..	10-11
Second. The Deductibility of Income Paid to Beneficiaries	11-14
Statutes Involved	14-16
Summary of Argument	16-17
Argument	17-31

ALPHABETICAL LIST OF AUTHORITIES

<i>Cases</i>	<i>Page</i>
Bowers v. Kerbaugh-Empire Co., 271 U. S. 170.....	19
Burnet v. Sanford and Brooks Company, 282 U. S. 359	5, 20
Burnet v. Whitehouse, 283 U. S. 148.....	3, 8, 28, 30
Coates, Jane B., 3 B.T.A. 429	
Commissioner v. Liberty Bank and Trust Company, (C.C.A. 6th, 1932), 59 F. (2d) 320.....	22
Eisner v. Macomber, 252 U. S. 189.....	19
Farmers & Merchants Bank v. Commissioner (C.C.A. 6th, 1932), 59 F. (2d) 912.....	20
Pardee v. Commissioner, 23 B.T.A. 846.....	29
Helvering v. Pardee, 290 U. S. 365, 370.....	3, 8, 29, 31
Inland Products Company v. Blair (C.C.A. 4th, 1929), 31 F. (2d) 867	5, 24
Jane B. Coates, 3 B.T.A. 429.....	20
Irwin v. Gavit, 268 U. S. 161.....	3, 7, 27
Leach v. Commissioner (C.C.A. 1st, 1931), 50 F. (2d) 371	6
McEachern v. Rose, 302 U. S. 56.....	6, 25
Nash v. Commissioner (C.C.A. 7th, 1937), 88 F. (2d) 477	22, 23
Riddle, T. P., 27 B.T.A. 1339	20

Statutes

Section 301(b) of the Revenue Act of 1926.....	10, 14, 18
Section 275(a) of the Revenue Act of 1928.....	11, 14
Section 22(b)(3) of the Revenue Act of 1932.....	14, 17, 27
Section 162(b) of the Revenue Act of 1932.....	15, 17, 27
Section 23(c) of the Revenue Act of 1934.....	21
Section 38 of Chapter 75 of the Acts of Indiana, 1931, Section 6-2438 of Burns Indiana Statutes Annotated, 1933	10, 15, 18, 26

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. _____.

THE UNION TRUST COMPANY OF INDIANAPOLIS,
as Former Executor of the Last Will and Testament of
William H. Block, Deceased,

Petitioner and Appellant, below,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellee below.

PETITION FOR WRIT OF CERTIORARI.

May it Please the Court:

The petitioner, The Union Trust Company of Indianapolis as former Executor of the Last Will and Testament of William H. Block, deceased, respectfully presents that:

I.

**SUMMARY STATEMENT OF THE MATTER
INVOLVED.**

This petition seeks review of a judgment of the Circuit Court of Appeals for the Seventh Circuit, which affirmed

122672

a judgment of the Board of Tax Appeals, confirming a deficiency assessment of income tax against petitioner for the calendar year 1932, in the amount of \$49,797.74, involving two separate and distinct controverted items.

First. The Commissioner included in petitioner's income for the calendar year 1932 a refund of \$603,983.25 federal estate tax received in that year as a consequence of additional credits for state estate tax imposed by a retroactive state law enacted in the year 1931, whereby the state took advantage of the additional 80% credit for state taxes granted by the Revenue Act of 1926. The effect of the retroactive tax imposed by the Indiana law of 1931 was merely to divert to the State of Indiana amounts previously paid as estate tax to the United States. While these amounts had been paid in the years 1930, 1931, and 1932, and deducted from petitioner's taxable income returned in those years, the fact that such refund would be made was known to the responsible taxing officials almost two and one-half months before limitations had barred a deficiency assessment on petitioner's return for the calendar year 1929, and such refund was actually received October 12, 1932, when there yet remained more than seventeen months to reassess petitioner's income tax liability for the year 1931, and more than five months to reassess the tax of 1930.

Petitioner contends that this refund was not in law income, that it could only be taxable as such by reason of some equitable estoppel arising from its prior deduction in computing taxable income; and since the impropriety of the previous deductions was discovered in ample time to have redetermined the liability for the prior years, it was not properly taxable as income in the year received.

Second. The Commissioner disallowed as deduction from petitioner's taxable income for the year 1932 \$105,-583.34 actually paid from income, and by the will of the testator directed to be paid annually from income, to various beneficiaries of the estate, upon what petitioner contends to be a mistaken application of the rule of *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Pardee*, 290 U. S. 365, 370. The Court concluded (we submit erroneously) that a direction in the will that any deficiency of income should be supplied by a pledge of corpus to be defrayed from future income, made the gifts payable at all events and from corpus, rendering applicable the rule of the case last cited rather than that of *Irwin v. Gavit*, 268 U. S. 161, which petitioner submits is applicable.

The opinion is found on pages 110 to 114 of the record, and is reported — Fed. (2d) —.

II.

JURISDICTION TO REVIEW THE JUDGMENT.

This Court has jurisdiction to review by virtue of Internal Revenue Code, Section 1141 (a), 26 U. S. C. A., Section 1141 (a) and Section 240 (a) of the Judicial Code, as amended. (28 U. S. C. A. s. 347, (a)). This petition, the annexed brief, and the record have been filed within the time prescribed by the Act of February 13, 1925, c. 229, s. 8, 43 Stat. 940, 28 U. S. C. A. s. 350, since the judgment of the Circuit Court of Appeals for the Seventh Circuit was entered February 27, 1940 (R. 115). No petition for a rehearing was filed.

III.

QUESTIONS PRESENTED.

1. Whether, under the Sixteenth Amendment and the Revenue Act of 1932, a refund of federal estate tax to an executor was taxable income in the year received.

2. Whether, under the Sixteenth Amendment and the Revenue Act of 1932, a refund of federal estate tax to an executor was taxable income in the year received merely by reason of the fact that the tax refunded had been taken as an allowable deduction from taxable income of prior years.

3. Whether, under the Sixteenth Amendment and the Revenue Act of 1932, a refund of federal estate tax to an executor was taxable income in the year received merely by reason of the fact that the tax refunded had been taken as an allowable deduction from taxable income of prior years, when the certainty of such refund was known to the Bureau of Internal Revenue in ample time to have re-determined the taxpayer's liability for all such prior years, and such refund was actually paid and received five months and seventeen months, respectively, before limitations had run on reassessment of the taxpayer's liability for two of such prior years.

4. Whether, under Section 22(b)3 and 162(b) of the Revenue Act of 1932, petitioner was taxable as a fiduciary upon income periodically paid to beneficiaries under express testamentary direction to make such payments from income, merely because the executor was directed to supply a deficiency of income by borrowing upon pledge of the corpus, which pledge was also directed to be discharged from future income.

IV.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. In holding that the refund of federal estate tax was *per se* taxable income in the year received, the Circuit Court of Appeals for the Seventh Circuit erroneously decided an important question of federal law which has not been but should be settled by this Court, in that the refund of an estate tax does not, without more, constitute income within the meaning of the Sixteenth Amendment and the Revenue Act of 1932.

2. In holding that the refund of federal estate tax was *per se* taxable income in the year received, the Circuit Court of Appeals for the Seventh Circuit erroneously interpreted and misapplied the decision of this Court in *Burnett v. Sanford and Brooks Co.*, 282 U. S. 359, in that the tax in question in the latter case had, as an expense of operations, operated to reduce actual net income in the year paid, and its refund amounted to the deferred receipt of income, whereas the tax in question in the instant case was a capital levy, which bore no relation to the earning of income, and constituted a restoration of capital when refunded.

3. In holding that petitioner's tax liability on account of the refunded federal estate tax should be adjusted by treating the refund as income in the year refunded, rather than by redetermining liability upon the returns of prior years in which the amount of the tax had been deducted from taxable income, the Circuit Court of Appeals has rendered a decision in conflict with the decisions of the Circuit Court of Appeals for the Fourth Circuit in *Inland Products Co. v. Blair*, (C. C. A. 4th, 1929), 31 F. (2d) 867,

and *Leach v. Commissioner of Internal Revenue*, (C. C. A. 1st, 1931), 50 F. (2d) 371.

4. In holding that the refund of federal estate tax was taxable to petitioner in the year received, because the refunded estate tax had been deducted from taxable income in the years in which paid and because "it is now too late to revise the returns for those years and to require the petitioner to pay the tax which would have been required of it except for the wrongful deductions," and in ignoring the fact that when the refund was made it was *not too late* "to revise" two of the prior returns, and that the Bureau knew of the impending refund in time to have revised all of the prior returns, the Circuit Court of Appeals for the Seventh Circuit has decided (we submit erroneously) an **important question** of federal law which has not been but should be settled by this Court.

5. In holding that the refund of federal estate tax was taxable to petitioner in the year received, because the refunded estate tax had ben deducted from taxable income in the years in which paid and because "it is now too late to revise the returns for those years and to require the petitioner to pay the tax which would have been required of it except for the wrongful deductions," and in ignoring the fact that *when the refund was made* it was *not too late* "to revise" two of the prior returns, and that the Bureau knew of the impending refund in time to have revised all of the prior returns, the Circuit Court of Appeals for the Seventh Circuit has in effect decided that such circumstances estop the taxpayer to deny the taxability as income of items not otherwise taxable as such because of benefits received in prior years, in probable conflict with the decision of this Court in *McEachern v. Rose*, 302 U. S. 56.

6. In holding that bequests of income to be paid annually, which were actually paid from income, were not deductible from petitioner's fiduciary return of income under Section 162(b) of the Revenue Act of 1932, because of the direction to make up deficiency of income by loans upon pledge of the corpus of the estate to be discharged from future income, the Circuit Court of Appeals has decided a question of federal law in probable conflict with the decision of this Court in *Irwin v. Gavit*, 268 U. S. 161.

7. The decision of the Circuit Court of Appeals is in probable conflict with *Irwin v. Gavit*, 268 U. S. 161, in that the testamentary direction to supply deficiency of income by pledge of the corpus to be discharged from future income did not change the bequests of income into bequests payable at all events, since the receipt by the beneficiary of other than income was conditioned not only upon ability to borrow but also upon there being a reasonable probability of future income sufficient to discharge the pledge, hence payments of income were properly deductible under Section 162(b) of the Revenue Act of 1932.

8. The Circuit Court of Appeals has erroneously decided an important question of federal law as to the application of Sections 162(b) and 22(b)(3) of the Revenue Act of 1932 which has not been but should be settled by this Court, in that it has held that a bequest of income only, followed by a direction to supply any deficiency of income by pledge of the corpus to be discharged from future income, constitutes a single bequest payable at all events so that payments of *income* made pursuant thereto are not deductible from fiduciary returns of income under Section 162(b) of the Revenue Act of 1932.

9. If the non-deductibility of income payments made to the income beneficiaries of the testator is deemed to

be concluded by the decisions in *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Pardee*, 290 U. S. 365, 370, petitioner respectfully submits that the rule of those cases should be modified to exclude the instant case, where bequests payable and paid from income only are supplemented with a further bequest, not of corpus or proceeds thereof, but of money to be obtained by loans payable only from future income.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 7034, and entitled, "The Union Trust Company of Indianapolis, as Former Executor of the Last Will and Testament of William H. Block, Deceased, Petitioner, v. Commissioner of Internal Revenue, Respondent," and that the judgment of the United States Circuit Court of Appeals for the Seventh Circuit in said case may be reversed by this Court, and that your petitioner may have such other and further relief in the premises as to this Court may seem meet and just; and your petitioner will ever pray.

THE UNION TRUST COMPANY OF
INDIANAPOLIS

As Former Executor of the Last Will and
Testament of William H. Block, Deceased,

By PAUL Y. DAVIS,

KURT F. PANTZER,

Counsel for Petitioner.

DAVIS, PANTZER, BALTZELL & SPARKS,

Indianapolis, Indiana,

Of Counsel.

